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Death and Taxes or Death without Taxes;Note

Peter J. Kosydar

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“DEATH AND TAXES” OR DEATH WITHOUT TAXES?

Peter J. Kosydar, III

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INTRODUCTION

Although he might not have known it, George Steinbrenner potentially saved his heirs \$500 million by dying on July 13, 2010.¹ In the year 2009, the estate tax in the United States was forty-five percent, meaning that Steinbrenner’s heirs would have owed nearly \$500 million dollars in taxes upon receiving his \$1.1 billion estate.² At the date of his death, a fifty-five percent estate tax rate was set to take effect on January 1, 2011, which would have led to his heirs paying closer to \$600 million dollars in taxes.³ However, as a result of the George W. Bush administration tax-cuts, the estate tax was repealed for the year 2010. In addressing the planned expiration of the Bush tax cuts in December of 2010, Congress decided not to require an estate tax to be imposed retroactively on the estates of those who died during 2010, meaning that Steinbrenner’s fortune passed to his heirs tax-free.⁴

The Bush tax cuts were put into effect in the year 2001, and many people assumed that with the election of President Barack Obama in 2008, Congress would reinstate the estate tax with a compromise tax rate for the year 2010.⁵ However, as a result of the inaction of Congress, the issue of the estate tax was not addressed until December 17, 2010.⁶ There was much speculation as to how Congress would choose to address this lack of estate tax in 2010 as many analysts and politicians debated the issue. It was speculated that the year-long gap in the estate tax could cost the U.S. treasury an estimated \$14.8 billion, and after numerous highly publicized deaths of wealthy individuals this year, many prominent attorneys and senators began to notice this major effect of the lack of estate tax.⁷ “In the midst of this terrible recession, the idea of giving billionaires a massive tax break is obscene,” stated Sen. Bernard Sanders of Vermont.⁸ “Already we have four billionaire families who are not paying taxes – Steinbrenner’s being the last one. Many billions are being lost. We have to address that reality right now.”⁹ Henry

* Candidate for Juris Doctor, 2012, Notre Dame Law School. I would like to thank my parents, Peter and Martha Kosydar, for everything they have done for me over the past 25 years. I would like to thank my brother, Nathan Kosydar, for his unwavering loyalty and support. I would like to thank Professor Michael Kirsch for helping me throughout this note-writing process. Finally, I would like to thank Natalie Warrick for making my time at Notre Dame such a special experience and for helping me track down all of the original sources for this Note.

1. See, e.g., *How Steinbrenner Saved His Heirs a \$600 Million Tax Bill*, WALL ST. J., July 13, 2010, <http://blogs.wsj.com/metropolis/2010/07/13/how-steinbrenner-saved-his-heirs-a-600-million-tax-bill/>.

2. *Id.*

3. *Id.*

4. *Id.*

5. See Brad Hamilton & Jeane MacIntosh, *Death’s Perfect Timing*, N.Y. POST, July 14, 2010, http://www.nypost.com/p/news/local/death_perfect_timing_NusLyGiMu8cn8kyeprVJP.

6. Tax Relief, Unemployment Insurance Reauthorization, and Job Creation Act of 2010, Pub. L. No. 111-312, 124 Stat. 3296 (2010).

7. See Peter Whoriskey, *Steinbrenner Heirs Could Save Millions From One-Year Gap in Estate Tax*, WASH. POST, July 14, 2010, <http://www.washingtonpost.com/wp-dyn/content/article/2010/07/13/AR2010071305028.html>.

8. *Id.*

9. *Id.*

Christensen, a partner at McDermott Will & Emery and the president of the International Academy of Trust and Estate Counsel, echoed a similar sentiment to that of Sen. Sanders stating “[b]ecause of Mr. Steinbrenner’s public name and stature, his death may draw the attention of Congress—they simply have to decide what to do.”¹⁰

This debate came to an end on December 17, 2010, when Congress enacted the *2010 Tax Relief Act*, which did not prevent this one-year estate tax gap.¹¹ Although the *Act* imposed a thirty-five percent estate tax rate for 2010, it stated that, in order to prevent potential hardships of retroactive legislation, the estates of decedents who died prior to its enactment could elect to apply the original 2010 law of no estate tax.¹² Therefore, this 2010 estate tax enacted by Congress was not applied to the Steinbrenner estate (and to the estates of the other 3 billionaires that died in 2010), allowing the heirs to inherit their father’s estate tax- free.

The Steinbrenner family would have faced a potentially complicated decision if the tax legislation had been imposed retroactively by Congress. As an article written in the *New York Post* on July 14, 2010 speculated, if required to pay taxes on their father’s estate, the Steinbrenner heirs would have been forced to sell their father’s share of the New York Yankees in order to pay the taxes.¹³ However, because of their ability to elect out of the *2010 Tax Relief Act*, the Steinbrenners will be able to keep the legendary baseball team that George Steinbrenner had owned for the past 37 years.¹⁴ Therefore, the question this note will address is: Would it have been constitutional for Congress to apply the *2010 Tax Relief Act* retroactively?

This note will discuss whether it would be constitutional for Congress to retroactively apply an estate tax to those wealthy individuals who died in 2010 and, if so, whether there would be any limitations Congress must consider in applying the tax. The note will also discuss the ramifications of Congress enacting a retroactive estate tax, and whether its negative effect on taxpayers would outweigh its benefit to the United States.

Part I of this note will begin by looking at the opposing views regarding the estate tax and the history of the estate tax in the United States. Part II will look at the history of retroactive legislation to see how it has been used by Congress and how it has been considered by the Supreme Court. Part III will discuss the specific arguments used by taxpayers against retroactive tax legislation, and will examine how courts have decided on each argument in the past. Part IV will examine the Supreme Court’s most recent decision regarding retroactive taxes: *United States v. Carlton*. Part V will discuss the specific arguments used by the taxpayer against retroactive estate tax legislation in *NationsBank v. United States* and will examine how the Court of Appeals decided on each argument. Part VI, will look at the potential ramifications of allowing Congress to impose a retroactive estate tax for

10. *Id.*

11. Tax Relief, Unemployment Insurance Reauthorization, and Job Creation Act, 124 Stat. 3296.

12. *Id.*

13. Hamilton & MacIntosh, *supra* note 5.

14. *Id.*

2010. Finally, Part VII will determine whether Congress could constitutionally impose an estate tax on decedents who died in 2010 based on the history of the estate tax and the recent case law relating to retroactive implementation of estate taxes. It will then discuss whether the negative effect that such a tax would have on taxpayers outweighs the benefit it would provide to the United States.

PART I: BACKGROUND ON ESTATE TAX

Part I.A examines two theories of wealth transfers. The first theory of wealth transfer, illustrated by John Locke, is used as support against the estate tax. The second theory, illustrated by Thomas Jefferson, supports the belief that the estates of wealthy individuals should be taxed before being passed down to their heirs.

Part 1.B looks at the Constitutional support for the estate tax and Congress' motivation in enacting the tax. It then tracks the development of the estate tax from its enactment in 1916 to its current position in our society in 2011.

A. *Opposing views on the taxation of wealth*

Since before the founding of the United States, scholars have debated whether the amount of wealth a decedent can transfer to his heirs at death should be limited. The opposing views of John Locke and Thomas Jefferson exemplify the debate that is still maintained in our society today. In *Two Treatises of Government*, John Locke stated that a parent must be allowed to bequeath his property to his children.¹⁵ Locke stated, "God Planted in Men a strong desire also of propagating their Kind, and continuing themselves in their Posterity, and this gives Children a Title, to share in the Property of their Parents, and a Right to Inherit their Possessions."¹⁶ Thomas Jefferson had a different view of wealth transfers at death, stating in a letter to James Madison that "the earth belongs in usufruct to the living; the dead have neither powers nor rights over it. The portion occupied by any individual ceases to be his when he himself ceases to be, and reverts to society."¹⁷

This debate on the estate tax and wealth transfer will continue to be a major issue in the future of the United States, as a recent study conducted by John J. Havens and Paul G. Schervish estimates that between 1998 and 2052 at least \$41 trillion will be transferred from one generation to the next.¹⁸

B. *The Development of the Estate Tax*

The Constitution of the United States grants to Congress the power of taxation

15. JOHN LOCKE, TWO TREATISES OF GOVERNMENT 88 (Sir Robert Filmer ed., The Legal Classics Library 1994) (1690).

16. *Id.*

17. Letter from Thomas Jefferson to James Madison (Sept. 6, 1789)
<http://teachingamericanhistory.org/library/index.asp?document=2220>.

18. John J. Havens & Paul G. Schervish, *Why the \$41 Trillion Wealth Transfer Estimate is Still Valid: A Review of Challenges and Comments*, 7 J. GIFT PLAN. 11 (Jan. 2003).

in Article I, Section 8 which states, “The Congress shall have the power To lay and collect Taxes, Duties, Imposts, and Excises, to pay the Debts and provide for the common Defense and general Welfare of the United States. . .”¹⁹ Using the power granted to it under this section, Congress adopted the estate tax in 1916 to raise revenue during World War I and in response to concerns about the negative social effects of wealth concentration.²⁰ In the seventy years after its enactment, the estate tax was viewed by most Americans as a necessary tool to curb concentrations of wealth.²¹ However, the support for the estate tax diminished in the 1990s as conservative lobbyists and members of Congress were able to gain the support of the majority of the public in opposing what they referred to as the “death tax”.²²

President Bill Clinton was able to prevent conservative legislators from eliminating the estate tax by overriding Congressional votes to repeal it in the years 1999 and 2000,²³ but President George W. Bush vowed to cooperate with estate tax repeal efforts in his campaign for the presidency in 2000. After his election, President Bush came through on this promise to conservative voters by signing *The Economic Growth and Tax Relief Reconciliation Act of 2001*.²⁴ This legislation increased the estate tax exemption amount and reduced the tax rates from 2002 to 2009.²⁵ The *Act* completely repealed the estate tax in 2010.²⁶ However, because the Senate’s “Byrd Rule” requires that legislation affecting revenue beyond a ten-year period be passed by a sixty percent majority, the *Act* was to “sunset” in 2011.²⁷ Therefore, under the *Act*, after 2011 the fifty-five percent estate tax rate that was in effect in 2001 was to be reinstated.²⁸

PART II: HISTORY OF RETROACTIVE LEGISLATION

Part II.A examines how retroactive legislation was viewed in the early United States and how it has been used generally in the history of the country. Part II.B examines how retroactive tax legislation differs from general retroactive legislation. It then analyzes how retroactive tax legislation, specifically, has been viewed by the courts of the United States.

A. *Retroactive Legislation - Generally*

A retroactive statute is defined as “one which gives to preenactment conduct a

19. U.S. CONST. art. I, § 8, cl. 1.

20. James R. Repetti, *Democracy, Taxes, and Wealth*, 76 N.Y.U. L. REV. 825 (2001).

21. Paul L. Caron & James R. Repetti, *The Estate Tax Non-Gap: Why Repeal a “Voluntary” Tax?*, 20 STAN. L. & POL’Y REV. 153,155 (2009).

22. *Id.*

23. Taxpayer Refund and Relief Act of 1999, H.R. 2488, 106th Cong. (1st. Sess. 1999); Death Tax Elimination Act of 2000, H.R. 8, 106th Cong. (2d Sess. 2000).

24. Caron & Repetti, *supra* note 21, at 155.

25. The Economic Growth and Tax Relief Reconciliation Act of 2001, Pub. L. No. 107-16, 115 Stat. 38.

26. *Id.*

27. Caron & Repetti, *supra* note 21, at 155.

28. *Id.*

different legal effect from that which it would have had without the passage of the statute."²⁹ In *The Federalist No. 44*, James Madison expressed concerns regarding retroactive legislation.³⁰ Madison stated that:

[b]ills of attainder, ex post facto laws, and laws impairing the obligation of contracts, are contrary to the first principles of the social compact, and to every principle of sound legislation. . . The sober people of America are weary of the fluctuating policy which has directed public councils. They have seen with regret and indignation that sudden changes and legislative interferences, in cases affecting personal rights, become jobs in the hands of enterprising and influential speculators, and snares to the more industrious and less informed part of the community. They have seen, too, that one legislative interference is but the first link of a long chain of repetitions, every subsequent interference being naturally produced by the effects of the preceding. They very rightly infer, therefore, that some thorough reform is wanting, which will banish speculations on public measures, inspire general prudence and industry, and give a regular course to the business society³¹

However, while Madison expressed a view which implied a fear of retroactive legislation, nothing in the Constitution prevented Congress from enacting civil laws retroactively.³² An early illustration of the lack of such provision came in *Dash v. Van Kleeck*, in which the Supreme Court of New York held that "[i]t is not pretended that we have any express constitutional provision on the subject" of retroactive civil law."³³ Although lower courts held that the Constitution did not explicitly prevent retroactive civil legislation, the Supreme Court later qualified this belief, illustrated by the court in *Dash*, holding that there could be a circumstance when a retroactively applied tax is "so harsh and oppressive as to transgress the constitutional limitation."³⁴

B. *Retroactive Taxation*

In his analysis of how the Supreme Court handled retroactive legislation prior to 1960, Charles Hochman stated that the retroactive imposition of taxes must be viewed separately from other retroactive legislation.³⁵ He stated that the Court was very reluctant to go against the judgment of Congress regarding retroactive taxation because of the government's paramount interest in obtaining tax revenues.³⁶ He

29. Charles B. Hochman, *The Supreme Court and the Constitutionality of Retroactive Legislation*, 73 HARV. L. REV. 692, 692 (1960).

30. See THE FEDERALIST No. 44 (James Madison).

31. *Id.*

32. See generally *Dash v. Van Kleeck*, 7 Johns. 477 (N.Y. Sup. Ct. 1811).

33. *Id.* at 505.

34. *Welch v. Henry*, 305 U.S. 134, 147 (1938).

35. Hochman, *supra* note 29 at 706.

36. *Id.*

also distinguished retroactive tax legislation from retroactive legislation involving penalties or contractual obligations, stating that taxes are “a means of apportioning the costs of government among those who benefit from it,” and therefore, receive more deference from the Court.³⁷

In cases involving retroactive taxation, Hochman stated that the Court has two major considerations: First, the Court looks at the ability of the taxpayer, at the time of the transaction in dispute, to have reasonably foreseen that a tax would be imposed at a later date.³⁸ Second, the Court considers the likelihood that, if the taxpayer had been able to foresee the retroactive tax, he would have altered his conduct to avoid it.³⁹ Hochman came to the conclusion that, based on the Court’s considerations, it would not be invalid for Congress to impose a tax if the taxpayer acted in reliance on the nontaxability of the income.⁴⁰

As a result of the Court’s deference to the legislature regarding retroactive tax legislation, Congress enacted retroactive tax increases thirteen times between 1917 and 1976.⁴¹ Following this precedent, President Bill Clinton signed the *Omnibus Budget Reconciliation Act of 1993* (hereafter “OBRA”). Section 13208 of this *Act*, which was enacted in August of 1993, retroactively raised the estate tax rate from fifty percent to fifty-five percent for the prior eight months, starting from January 1 of 1993.⁴² The constitutionality of §13208 of the *OBRA* was questioned in *NationsBank v. United States*. The court’s analysis of this case will be discussed more thoroughly in Part V.

PART III: ARGUMENTS USED BY TAXPAYERS AGAINST RETROACTIVE TAX- LEGISLATION

Part III examines the specific arguments that taxpayers have made against retroactive taxes by discussing the prior case law for each argument and analyzing how the arguments have developed in court over time. Part III will address each of the arguments in the same order that the United States Court of Appeals addressed them in *NationsBank*: Part III.A discusses the Apportionment Clause, Part III.B focuses on the Ex Post Facto Clause, Part III.C discusses the Takings Clause, Part III.D examines the Due Process Clause, and Part III.E looks at the Equal Protection Clause of the 14th Amendment.

37. *Id.*

38. *Id.*

39. *Id.*

40. *Id.* at 706-07.

41. See Andrew G. Schultz, Note, *Graveyard Robbery in the Omnibus Reconciliation Act of 1993: A Modern Look at the Constitutionality of Retroactive Taxes*, 27 J. MARSHALL L. REV. 775, 814 n.273 (1994).

42. *Id.* at 775-776.

A. The Apportionment Clause

The first argument that taxpayers have made against retroactive tax legislation is that it violates the Apportionment Clause under Article 1, Section 9 of the Constitution. The Apportionment Clause states that, "No Capitation, or other direct, Tax shall be laid, unless in Proportion to the Census or Enumeration herein before directed to be taken."⁴³ The Supreme Court elaborated that a tax is direct, and in violation of the Apportionment Clause, if it is levied directly on property.⁴⁴ A tax is not direct, however, if it is levied on the transfer of property from one individual to another.⁴⁵

Milliken v. United States is an example of a case in which a taxpayer challenged a retroactive estate tax on the basis that it was an unapportioned direct tax.⁴⁶ In *Milliken*, a decedent gave each of his children corporate stock in 1916, three years prior to his death.⁴⁷ After the father's death, the Commissioner included the shares of stock given to the children in the decedent's estate as a gift made in contemplation of death.⁴⁸ The tax owed by the heirs was computed based on the value of the stock at the time of the decedent's death and using the tax rate provided for in the *Revenue Act of 1918* (which was higher than the tax rate provided for in the *Revenue Act of 1916* at the time the gift was made).⁴⁹ The executor of the estate argued that the higher tax rate was a direct tax, because it was retroactive in that it was measuring the tax by rates not in force at the time the gift was made.⁵⁰

The Supreme Court held that the higher tax rate was not a direct tax because it was still a tax on an event – the giving of the gift of stock.⁵¹ In his opinion for the majority, Justice Stone stated that, "[t]he present gift was subject to the excise when made, and . . . a mere increase in the tax, pursuant to a policy of which the donor was forewarned at the time he elected to exercise the privilege, did not change its character."⁵²

B. The Ex Post Facto Clause

The next argument taxpayers have made against retroactive legislation is that it is a violation of the Ex Post Facto Clause under Article 1, Section 9 of the Constitution, which states that, "[n]o Bill of Attainder or ex post facto Law shall be passed."⁵³ An ex post facto law is defined as a law that is "passed after the

43. U.S. CONST. art. I, §9 cl. 4.

44. *Nations Bank v. U.S.*, 269 F.3d 1332, 1335 (Fed. Cir. 2001).

45. *Id.*

46. *Milliken v. U.S.*, 283 U.S. 15 (1931).

47. *Id.* at 18.

48. *Id.* at 19.

49. *Id.*

50. *Id.* at 20.

51. *Id.* at 24.

52. *Id.*

53. U.S. CONST. art. I, § 9, cl. 3.

occurrence of a fact or commission of an act, which retroactively changes the legal consequences or relations of such fact or deed.”⁵⁴ With respect to the hypothetical situation in which Congress had elected to enact retroactive estate tax legislation in 2010, the taxpayer’s argument would be that because the legislation occurred after the death of the decedent, it is changing the legal consequences of his death, and is therefore unconstitutional.

The first major case in which a party attempted to use the Ex Post Facto Clause to argue against retroactive civil legislation was *Calder v. Bull*.⁵⁵ In *Calder*, it was argued by the plaintiffs in error that a resolution passed by the Connecticut legislature, which set aside their previously favorable judgment from a probate court, was an ex post facto law under the Constitution and therefore invalid.⁵⁶ In its decision, the Supreme Court limited the scope of the Ex Post Facto Clause to apply only to criminal statutes.⁵⁷ In the opinion written for the majority, Justice Chase stated that he did not believe that the Ex Post Facto Clause “was inserted to secure the citizen in his private rights, of either property or contracts . . . [B]ut the restriction not to pass any ex post facto law, was to secure the person of the subject from injury, or punishment, in consequence of such law.”⁵⁸ He then went on to list the four types of laws he considered to be within the words of the prohibition, all of which were related to criminal offenses.⁵⁹ These included: laws making something a crime when it was not a crime at the time it was committed, laws aggravating a crime after it was committed, laws enhancing the punishment of a crime after it was committed, and laws reducing the level of evidence necessary to convict an offender after the act was committed.⁶⁰

However, eighty years later the Supreme Court came to a different conclusion in a case involving retroactive tax legislation. In *Burgess v. Salmon*, the Supreme Court held that a retroactive tobacco tax enacted by the government was unconstitutional as an ex post facto law.⁶¹ In his opinion for the Court, Justice Hunt stated that the tax increase was unconstitutional because the government had the option “[t]o impose upon the owner of the goods a criminal punishment or a penalty” for refusing to pay the increased taxes before the tax became effective.⁶²

In a much more recent case decided in 1999, *Quarty v. U.S.*,⁶³ taxpayers again attempted to use the Ex Post Facto Clause in a criminal context to challenge the constitutionality of a retroactive tax, however in this case they were unsuccessful in their argument. In *Quarty*, the taxpayers were challenging the constitutionality of §13208 of the *OBRA*. Because the taxpayer’s wife had died on January 12, 1993, when the tax rate was fifty percent, the retroactive estate tax increase to fifty-five

54. BLACK’S LAW DICTIONARY 520 (5th ed. 1979).

55. *Calder v. Bull*, 3 U.S. 386 (1798).

56. *Id.* at 387.

57. *Id.* at 390.

58. *Id.*

59. *Id.*

60. *Id.*

61. *Burgess v. Salmon*, 97 U.S. 381, 384 (1878).

62. *Id.* at 384-85.

63. *Quarty v. U.S.*, 170 F.3d 961 (9th Cir. 1999).

percent raised his tax liability by an additional \$228,683.⁶⁴ The taxpayers argued that because the willful failure to pay estate taxes subjects a taxpayer to criminal liability, retroactively increasing such taxes is an ex post facto law because the taxpayer would be subject to criminal punishment for the failure to pay the difference in the increase in tax over the rate that existed at the time of the transfers.⁶⁵ While the court agreed with the taxpayer's position that the failure to pay the increase in taxes would cause a criminal penalty, this time it held against the taxpayer's ex post facto argument.⁶⁶ The court reasoned that the estate tax did not have to be paid until nine months after the death of the decedent, and by this time the new law was in place.⁶⁷

Therefore, based on the court's more recent opinion in *Quarty*, if Congress retroactively changes the estate tax rate after the death of the decedent but before the payment of the tax is due, it will probably not be viewed as a violation of the Ex Post Facto Clause.

C. The Takings Clause

The Takings Clause of the Fifth Amendment states: "nor shall private property be taken for public use, without just compensation."⁶⁸ In *Kane v. United States*, the taxpayer attempted to use the Takings Clause to support his argument that §13208 of the *OBRA*, which retroactively increased the estate taxes from fifty percent to fifty-five percent, was unconstitutional.⁶⁹ In holding against the taxpayer, the District Court stated that "[t]he Supreme Court has held that the Constitution can consistently allow Congress to tax income while prohibiting Congress from unlawful takings."⁷⁰ Therefore, the District Court stated that the proper test in analyzing whether a retroactive tax was a taking under the Takings Clause was to determine whether the statute was "so arbitrary as to amount to a confiscation of property rather than an exaction of tax."⁷¹ In looking at §13208 of the *OBRA*, the court held that while the tax rate was high, it was not so arbitrary as to amount to a confiscation, and therefore, was not a taking.⁷²

D. The Due Process Clause

The Due Process Clause in the Fifth Amendment of the Constitution states that no person shall "be deprived of life, liberty, or property, without due process of

64. *Id.* at 964.

65. *Id.* at 965.

66. *See id.* at 973.

67. *Retroactive Reinstatement of Top Estate and Gift Tax Rates Under Sections 2001 and 2501 to 53 and 55 Percent is not Unconstitutional Taking or Ex Post Facto Law*, 115 *BANKING L.J.* 422, 422-23(1998).

68. U.S. CONST. amend. V.

69. *Kane v. U.S.*, 942 F. Supp. 233, 234 (E.D. Pa. 1996).

70. *Id.*

71. *Id.*

72. *See id.*

law.”⁷³ In *Nichols v. Coolidge*, the Supreme Court recognized that a retroactive tax statute “may be so arbitrary and capricious as to amount to confiscation and offend the Fifth Amendment.”⁷⁴ This argument has been used by numerous taxpayers in cases involving retroactive tax legislation.

In *Nichols*, after the decedent died in 1921, the Commissioner of the IRS attempted to include property that she had transferred to others in 1917 as part of her estate for purposes of the estate tax.⁷⁵ Although the transfer took place in 1917, the Commissioner justified his decision to include the transferred property in the decedent’s estate based on section 402(c) of the *Revenue Act of 1919*.⁷⁶ In its decision in favor of the taxpayer, Supreme Court held that because section 402(c) required the value of property transferred prior to its passage to be included in the gross value of the estate, it was of “arbitrary, whimsical and burdensome character” and, therefore, invalid.⁷⁷

However, the decision in *Nichols* was limited in *Milliken v. United States*, which held that a retroactive tax was not an unconstitutional violation of due process.⁷⁸ The taxpayer’s challenge in *Milliken* was similar to the challenge by the taxpayer in *Nichols*, involving the IRS Commissioner using section 402(c) of the *Revenue Act of 1918* to include shares of stock the decedent transferred prior to his death in his estate for purposes of the estate tax.⁷⁹ Like the case in *Milliken*, the taxpayer argued that this statute was a denial of due process in that it retroactively reached a gift made before its enactment and that it measured the tax by rates not in effect when the gift was made.⁸⁰

However, in holding against the taxpayer in *Milliken*, the Supreme Court limited its prior decision in *Nichols* stating that in that case it was determined that the statute could not constitutionally be applied “to a gift inter vivos, not in contemplation of death, and made long before the adoption of any congressional legislation imposing an estate tax. . . .”⁸¹ It stated that in *Nichols* the legislation was an infringement of the Due Process Clause because the gifts made by the taxpayer were “completely vested beyond recall.”⁸² The Court went on to say that “a tax is not necessarily and certainly arbitrary and therefore invalid because retroactively applied. . . [I]t does not suffice to say that the gift antedated the statute.”⁸³ In determining whether a retroactive statute violated a taxpayer’s due process, the Court stated that it was “necessary to consider the nature of the tax and of the decedent’s gift.”⁸⁴ In this case, because there was no uncertainty that the transfer

73. U.S. CONST. amend. V.

74. *Nichols v. Coolidge*, 274 U.S. 531, 542 (1927).

75. *Id.* at 532-33.

76. *Id.* at 533.

77. *Id.* at 542-43.

78. *Milliken*, 283 U.S. at 24-25.

79. *Id.* at 19.

80. *Id.* at 20.

81. *Id.* at 21.

82. *Id.* at 20-21.

83. *Id.* at 21-22.

84. *Id.* at 22.

would be taxed as a testamentary gift under the provision of the 1916 statute, it was not a violation of due process to apply the higher rate of 1918.⁸⁵

Seven years later, in *Welch v. Henry*, the Supreme Court again denied a taxpayer's claim that a retroactive tax was a violation of due process.⁸⁶ In his opinion for the Court, Justice Stone provided further support for the holding that retroactive taxation is not a violation of due process. He stated:

Taxation is neither a penalty imposed on the taxpayer nor a liability which he assumes by contract. It is but a way of apportioning the cost of government among those who in some measure are privileged to enjoy its benefits and must bear its burdens. Since no citizen enjoys immunity from that burden, its retroactive imposition does not necessarily infringe due process.⁸⁷

E. The Equal Protection Clause

The Equal Protection Clause of the Fourteenth Amendment prevents a state from denying "to any person within its jurisdiction the equal protection of the laws."⁸⁸ While this provision is directly applicable to the states rather than to the federal government, in *Bolling v. Sharpe* the Supreme Court held that if a government action would be unconstitutional if taken by a state under the Fourteenth Amendment, it is unconstitutional under the Due Process Clause of the Fifth Amendment.⁸⁹ Therefore, another argument that has been used by taxpayers against retroactive tax legislation is that it violates their protections under the Equal Protection Clause.⁹⁰ The taxpayer argument is that because lawmakers are able to create tax statutes with retroactive effects, they can use hindsight in creating tax rates which allows them to target specific individuals or groups.⁹¹ The taxpayers argue that those individuals or groups targeted by the retroactive taxes are not receiving equal protection under the laws.⁹²

However, in *Welch v. Henry*, the Supreme Court created a standard which made it very difficult for taxpayers to argue that retroactive statutes denied them of equal protection under the laws.⁹³ In *Welch*, the taxpayer argued that a statute which retroactively taxed only the recipients of corporate dividends was a denial of equal protection.⁹⁴ In his opinion for the majority, Justice Stone stated that the appropriate test for determining whether a retroactively applied tax is a denial of equal protection is to ask "whether the thing taxed falls within a distinct class which

85. *See id.* at 23-24.

86. *Welch*, 305 U.S. at 134.

87. *Id.* at 146-47.

88. U.S. CONST. amend. XIV, § 1.

89. *See Bolling v. Sharpe*, 347 U.S. 497, 499 (1954).

90. Schultz, *supra* note 41 at 784.

91. *Id.*

92. *See id.*

93. *Welch*, 305 U.S. at 134.

94. *Id.* at 142.

may rationally be treated differently from other classes.”⁹⁵ The Court held against the taxpayer stating “[i]n the absence of any facts tending to show that the taxing act, in its purpose or effect, is a hostile or oppressive discrimination . . . we cannot say the taxing statute denies equal protection.”⁹⁶

PART IV: THE SUPREME COURT AND RETROACTIVE TAX LEGISLATION: *UNITED STATES V. CARLTON*

Part IV will begin by giving the background on the most recent Supreme Court case involving retroactive tax legislation: *United States v. Carlton*. It will then discuss the arguments made by both the taxpayer and the government in the case. Finally, it will examine the Supreme Court’s analysis of the taxpayer’s arguments and will determine what effect the Court’s holding could have on the constitutionality of a potentially retroactive estate tax for the year 2010.

Background on Carlton v. United States

The issue presented to the Supreme Court in *Carlton v. United States* was whether the retroactive application of the amendment to 26 U.S.C. §2057 violated the Due Process Clause of the Fifth Amendment.⁹⁷ The provision at issue in this case, which was part of the *Tax Reform Act of 1986* and applicable to any estate that filed a return after October 1986, 26 U.S.C. §2057, granted a deduction for half of the proceeds of “any sale of employer securities by the executor of an estate” to “an employee stock ownership plan.”⁹⁸ The only other requirement necessary to qualify for this deduction was that the sale of securities had to be made “before the date on which the estate tax return was required to be filed.”⁹⁹

The respondent in this case, Jerry Carlton, was the executor of Willametta Day’s estate. Ms. Day died on September 29, 1985 and her estate tax return was due on December 29, 1986, making her estate eligible for the deduction under §2057. Mr. Carlton sought to take the deduction under §2057 and purchased 1.5 million shares of MCI stock on December 10, 1986, which he then sold two days later at a loss of \$631,000. When Mr. Carlton filed the estate return on December 29, 1986, he claimed the deduction under §2057 which reduced his estate tax by \$2,501,161.¹⁰⁰

In December of 1987, the IRS enacted an amendment to §2057 which made the deduction available only to estates of decedents who owned the securities immediately before their deaths.¹⁰¹ The amendment was retroactively applied to

95. *Id.* at 145.

96. *Id.* at 146.

97. *U.S. v. Carlton*, 512 U.S. 26, 27 (1994).

98. *Id.* at 28 (quoting 26 U.S.C. §2057(1986)).

99. *Id.* (citing 26 U.S.C. §2057(1986)).

100. *Id.*

101. *Id.* at 29.

become effective from the date §2057 was originally enacted in October of 1986.¹⁰²

As a result of this retroactive amendment, the IRS disallowed the deduction Mr. Carlton claimed under §2057 on the ground that the stock had not been owned by Ms. Day immediately before her death. Mr. Carlton paid the deficiency but also filed a claim for refund arguing that the retroactive application of the amendment violated the Due Process Clause of the Fifth Amendment.¹⁰³

Ruling of the Court of Appeals

The United States Court of Appeals for the Ninth Circuit agreed with Mr. Carlton that the retroactive tax legislation was a violation of due process.¹⁰⁴ In coming to this decision, the court first rejected "the notion of a per se rule that tax statutes can always be retroactively applied so long as they do not create a 'wholly new' tax".¹⁰⁵ The court then used three criteria in order to determine whether the retroactive application of the amendment violated due process. The first factor the court considered in its decision was whether or not the taxpayer had "actual or constructive notice that the tax statute would be retroactively amended[.]"¹⁰⁶ The court concluded that the respondent lacked notice that the statute would be retroactively amended because "no act of the executive or legislative branch would have given any forewarning of the 1987 amendment at the time the MCI ESOP transaction occurred."¹⁰⁷

The second factor the court considered was whether the taxpayer relied "to his detriment on the pre-amendment tax statute."¹⁰⁸ The court determined that the taxpayer had "detrimentally relied" on §2057 because he had "engaged in a costly transaction for no other reason than the inducement provided by the new section 2057."¹⁰⁹ The court held that the \$631,000 loss on the taxpayers purchase and sale of MCI stock constituted the type of "detrimental reliance" that made retroactive application of the amendment unconstitutional.¹¹⁰

Lastly, the third factor that the court considered in its decision in favor of the taxpayer was whether his reliance on the pre-amendment tax statute was "reasonable".¹¹¹ Under this third factor, the court determined that the taxpayers reliance on §2057 was reasonable because of "the lack of any indication that an amendment was in the offing and in the context of the large tax incentives Congress has given to ESOPs."¹¹²

102. *Id.*

103. *Id.*

104. *Carlton v. U.S.*, 972 F.2d 1051, 1062 (9th Cir. 1992).

105. *Id.* at 1056.

106. *Id.* at 1059.

107. *Id.*

108. *Id.*

109. *Id.*

110. *See id.* at 1060.

111. *Id.* at 1059.

112. *Id.* at 1061.

Although the majority held that the taxpayer met the three criteria and that the retroactive application was unconstitutional, it was not a unanimous opinion.¹¹³ In dissent, Judge Norris stated that the retroactive application of the amendment was not unconstitutional noting that “[t]he Supreme Court and our sister circuits have made clear that constructive notice to the taxpayer is usually implied for a change in the rate or basis of an existing tax.”¹¹⁴

Following the ruling by the Court of Appeals for the Ninth Circuit, the United States appealed and the Supreme Court granted certiorari in 1993.¹¹⁵ The briefs of both parties and the opinion of the Supreme Court are discussed below:

Brief for the United States

In its brief to the Supreme Court, the United States made two main points to support its argument that the Court of Appeals had decided this case incorrectly.¹¹⁶ First, it argued that the amendment to §2057 satisfied the requirements of due process because it constituted a rational means of furthering a legitimate purpose.¹¹⁷ The second argument made by the United States was that the three-part test used by the Court of Appeals for determining whether the amendment satisfied the requirements of due process lacked any constitutional foundation.¹¹⁸

In support of its argument that the retroactive amendment met the requirements of due process, the United States quoted the Supreme Court’s decision in *Pension Benefit Guaranty Corp. v. R.A. Gray & Co.*, which stated that, “[p]rovided that the retroactive application of a statute is supported by a legitimate legislative purpose furthered by a rational means, judgments about the wisdom of such legislation remain within the exclusive province of the legislative and executive branches.”¹¹⁹ In support of this point, the brief further quoted from the Supreme Court’s decision in *Usery v. Turner*, stating that

[r]etroactive legislation drawn to achieve a legitimate purpose does not violate the Due Process Clause even if the statute imposes a liability that ‘was not anticipated’ or ‘upsets otherwise settled expectations’ and ‘even though the effect of the legislation is to impose a new duty or liability based on past acts’.¹²⁰

The brief further argued that legislation enacted by Congress to cure errors in prior tax legislation is especially fit for retroactive treatment, and therefore should not be held to be a violation of due process. In order to show that §2057 was meant as curative legislation to close unintended tax loopholes, the brief quoted the House

113. *Id.* at 1062.

114. *Id.* at 1064.

115. *U.S. v. Carlton*, 972 F.2d 1051 (9th Cir. 1992), *cert. granted*, 62 U.S.L.W. 3242 (U.S. Oct. 4, 1993)(No 92-1941).

116. *U.S. v. Carlton*, No. 92-1941, 1993 WL 638225 at *12 (U.S. Nov. 15, 1993).

117. *Id.* at 12.

118. *Id.* at 19.

119. *Pension Benefit Guaranty Corp. v. R.A. Gray & Co.*, 467 U.S. 717, 729 (1984).

120. *Id.* (quoting *Usery v. Turner Elkhorn Mining Co.*, 428 U.S. 1,16 (1976)).

Committee Report which stated that the original provision "would not have been adopted in its present form had the full extent of the revenue impact and the effect of the provision been recognized."¹²¹ The House Committee Report went on to say that "it is now necessary to modify the provision to bring the revenue loss in line with the original estimate and Congressional intent."¹²² Therefore, the brief argued, because an unintended loophole was written into the statute, and because Congress acted promptly to correct it, it could not be said that the retroactive correction violated the Due Process Clause.¹²³

After making its argument that the retroactive amendment furthered a legitimate legislative purpose, the brief for the United States then attacked the three-part test used by the Court of Appeals.¹²⁴ The brief for the petitioner argued that the first part of the criteria used by the court was invalid because every taxpayer is deemed to have constructive notice of the possibility of changes in the provisions of existing tax laws.¹²⁵ Quoting from *Milliken*, the brief stated that every taxpayer "should be regarded as taking his chances of any increase in the tax burden which might result from carrying out the established policy of taxation."¹²⁶

The brief then argued that the court further erred in holding that the taxpayer's reliance on the original provision was reasonable. Again citing *Usery*, the United States argued that "[a] taxpayer cannot 'reasonably' rely on the assumption that Congress will not retroactively cure its prior drafting errors."¹²⁷ Therefore, for the reasons discussed above, the United States argued that the decision of the Court of Appeals should be reversed.¹²⁸

Brief for Carlton

The brief for Carlton focused on the language from *Welch* stating that "a tax statute may not be applied retroactively if an unduly 'harsh and oppressive' result arises from the 'nature of the tax and the circumstances in which it is laid.'"¹²⁹ Applying the "harsh and oppressive" test from *Welch*, the brief for Carlton stressed that the retroactive amendment of § 2057 should be prohibited for four main reasons.¹³⁰ First, the respondent argued that the executor had no notice that Congress would revoke the deduction.¹³¹ Secondly, the brief stated that the executor relied on the availability of the deduction when entering into the

121. *Id.* (quoting H.R. Rep. No. 391, at 1045 (1987)).

122. *Id.*

123. Brief for Petitioner, *supra* note 115, at 17.

124. *Id.*

125. *Id.* (citing *Cohan v. Comm'r*, 39 F.2d 540, 545 (2d Cir. 1930).

126. *Id.* (quoting *Milliken*, 283 U.S. at 23).

127. *Id.* (quoting *Usery*, 428 U.S. at 16).

128. *Id.*

129. Brief for Respondant at 7, *U.S. v. Carlton*, No. 92-1941, 1993 WL 664654 (U.S. Dec. 14, 1993) (citing *US. v. Hemme*, 476 U.S. 558, 568-69 (1986) and *Welch v. Henry*, 305 U.S. 135, 147 (1938)).

130. *Id.* at 12.

131. *Id.*

transaction, and otherwise would not have engaged in it.¹³² Thirdly, it stated that the executor was injured as a result of selling the stock below market value.¹³³ Lastly, and most importantly, the respondent argued that unlike the prior cases cited by the United States, the statute in this case specifically induced the executor to further the public goal of promoting employee stock ownership.¹³⁴

The respondent's brief focused the majority of its attention on the fact that, in this case, the statute which was retroactively amended induced the taxpayer to act in the way that he acted. The brief argued that "[i]t is singularly harsh and oppressive for Congress to use the inducement of a tax benefit to encourage private support of the public goal of promoting stock ownership and, subsequently, to deny a taxpayer the very benefit that induced the purchase and sale."¹³⁵ Quoting Professor Laurence Tribe, the brief for the respondent stated that it is "'a simple constitutional principle,' that when it induces reliance, 'government must keep its word'".¹³⁶

The brief for the respondent also used the fact that the original tax provision had induced the taxpayer to engage in the transaction as a way to distinguish this case from the cases the United States was using to support its argument. The respondent argued that none of the cases cited by the United States involved "government inducement of a transaction to accomplish a public goal with private funds" and therefore, they were irrelevant to support the case at hand.¹³⁷

The Majority Opinion of the Supreme Court

After hearing the arguments by both the taxpayer and the United States, the Supreme Court overruled the decision of the Court of Appeals and held that the retroactive tax legislation was not a violation of due process because it was "rationally related to a legitimate legislative purpose."¹³⁸ In his opinion for the majority of the Court, Justice Blackmun stated, "the Court of Appeals held the congressional enactment to an unduly strict standard,"¹³⁹ and that the cases relied upon by the lower court in reaching its decision followed an approach that "has long been discarded."¹⁴⁰ In his analysis of the cases relied upon by the Court of Appeals, Justice Blackmun cited *United States v. Hemme*, stating, "[t]o the extent their authority survives, they have been limited to cases involving 'the creation of a wholly new tax,' and their 'authority is of limited value in assessing the constitutionality of subsequent amendments that bring about certain changes in operation of the tax laws.'"¹⁴¹

132. *Id.* at 12-13.

133. *Id.* at 13.

134. *Id.*

135. *Id.* at 6.

136. *Id.* at 10 (quoting LAURENCE H. TRIBE, *AMERICAN CONSTITUTIONAL LAW* 619 (2d ed., 1988)).

137. *Id.* at 64.

138. *Carlton*, 512 U.S. at 35.

139. *Id.* at 35.

140. *Id.* at 34.

141. *Id.* (quoting *Hemme*, 476 U.S. 568).

In its opinion, the Supreme Court focused on two main factors in holding that the retroactive amendment met the requirements of due process. First, the Court noted that Congress' purpose in enacting the amendment "was neither illegitimate nor arbitrary."¹⁴² In making this determination, the Court noted that there was little doubt that the amendment was adopted as a curative measure and that its action in correcting it was reasonable to prevent a significant and unexpected revenue loss.¹⁴³

The second factor that the Court noted was that "Congress acted promptly and established only a modest period of retroactivity."¹⁴⁴ The Court further elaborated on this point stating "[h]ere, the actual retroactive effect of the 1987 amendment extended for a period only slightly greater than one year."¹⁴⁵

The Court also addressed the taxpayer's specific arguments beginning with the fact that the retroactive amendment was a violation of due process because he had detrimentally relied on the preamendment version.¹⁴⁶ In response to this argument, the Court stated that "reliance alone is insufficient to establish a constitutional violation."¹⁴⁷ Instead, the Court stated that "[t]ax legislation is not a promise, and a taxpayer has no vested right in the Internal Revenue Code."¹⁴⁸

The Court similarly dismissed the taxpayer's argument that his lack of notice regarding the retroactive amendment made it a violation of due process.¹⁴⁹ In response to this argument, the Court cited its decision in *Milliken* stating that a taxpayer "should be regarded as taking his chances of any increase in the tax burden which might result from carrying out the established policy of taxation."¹⁵⁰

Justice O'Connor's Concurrence

Although Justice O'Connor agreed with the outcome reached by the majority, she wrote a concurring opinion in the case that differed from the reasoning given by the majority. She stated that the majority opinion's emphasis on Congress' "correcting" a "mistake" was irrelevant and that "it is sufficient for due process analysis if there exists some legitimate purpose underlying the retroactivity provision."¹⁵¹

Justice O'Connor also expressed a desire to limit the time period in which Congress can retroactively amend statutes, stating that "[t]he governmental interest in revising the tax laws must at some point give way to the taxpayer's interest in

142. *Id.* at 32.

143. *Id.* at 31-32.

144. *Id.* at 32.

145. *Id.* at 33.

146. *Id.*

147. *Id.*

148. *Id.*

149. *Id.*

150. *Id.* at 34 (citing *Milliken*, 283 U.S., at 23).

151. *Id.* at 36-37 (alteration in original).

finality and repose.”¹⁵² She stated that in every case where a retroactive statute survived a due process challenge, the law applied retroactively “only for a relatively short period prior to enactment” and that “[a] period of retroactivity longer than the year preceding the legislative session in which the law was enacted would raise, in my view, serious constitutional questions.”¹⁵³

PART V: ARGUMENTS USED AGAINST RETROACTIVE ESTATE TAX IN *NATIONS BANK*

NationsBank v. United States is a recent case involving retroactive tax legislation which interpreted the Supreme Court’s decision in *Carlton*. Because, in *NationsBank*, a tax was retroactively applied in a situation that is very similar that of the *2010 Tax Relief Act* (if it had been applied retroactively), it provides valuable insight into how the Supreme Court would potentially view a retroactive application of the *Act*. Part V will begin by giving the background of the *NationsBank* case. It will then give an analysis of all of the arguments made by the taxpayer and will discuss how the Federal Court of Appeals for the Federal Circuit held on each argument.

Background on NationsBank v. United States

NationsBank v. United States involved §13208 of the *OBRA*, which was signed into law by President Bill Clinton in August of 1993.¹⁵⁴ *NationsBank*, the plaintiff in this case, was the executor of Ms. Ellen Clayton Garwood’s estate and was seeking a refund on estate taxes paid after her death.¹⁵⁵ Ms. Clayton died in March of 1993, with a gross estate of over \$28 million, and following the retroactive rate increase provided for in §13208 of the *OBRA*, her estate was taxed at fifty-five percent rather than fifty percent.¹⁵⁶ In this case heard by the United States Court of Appeals for the Federal Circuit in 2001, the executor sought a refund of \$1,320,190.07, the difference in tax paid under the retroactively applied fifty-five percent rate and the former fifty percent rate that was in effect when the decedent died.¹⁵⁷ *NationsBank* asserted that this retroactive legislation violated several provisions of the Constitution, including: the Apportionment Clause, the Ex Post Facto Clause, the Takings Clause, the Due Process Clause, and the Equal Protection Clause.¹⁵⁸ However, as discussed below, after interpreting the decision of the Supreme Court in *Carlton*, the Court of Appeals held that the retroactive tax rate increase did not violate the Constitution and was therefore valid legislation.

152. *Id.* at 37-38.

153. *Id.* at 38.

154. *NationsBank*, 269 F.3d at 1334.

155. *Id.* at 1334.

156. *Id.*

157. *Id.*

158. *Id.*

Apportionment Clause Argument

Following the precedent set by the Supreme Court in *Milliken*, the court in *NationsBank* held that §13208 of the *OBRA* did not violate the Apportionment Clause.¹⁵⁹ The court stated that §13208 did not impose a new tax, but "merely increased the rate of the indirect tax on the transfer which had occurred earlier."¹⁶⁰ Citing *Milligan*, the court held that the five percent retroactive increase in the tax rate did not change the character of the estate tax from non-direct to direct.¹⁶¹ Because it held that the tax was still on the transfer or the property, rather than on the property itself, the Court held that §13208 was constitutional under the Apportionment Clause.¹⁶²

Ex Post Facto Argument

The court in *NationsBank*, similar to the court in *Quarty*, held that the increase in estate taxes under §13208 of the *OBRA* was not an ex post facto law.¹⁶³ The court began by stressing the language used in *Calder* which stated that the ex post facto provision applies solely to criminal enactments.¹⁶⁴ It then stated that although taxpayers are often subject to criminal liability for refusing to pay taxes, if the entire tax code were held to be criminal in nature, every retroactive tax law would become an unconstitutional ex post facto enactment.¹⁶⁵ The court stated that this could not be the correct interpretation of the Ex Post Facto Clause because the Supreme Court's decision in *Carlton* acknowledged Congress' constitutional authority to enact tax laws retroactively.¹⁶⁶

The court distinguished the facts of this case from that of *Burgess v. Salmon*, an 1878 case in which the Supreme Court held that a retroactive tax increase on tobacco constituted an ex post facto law.¹⁶⁷ In distinguishing this case from that of *Burgess*, the court emphasized that the taxpayers in *Burgess* could not have avoided the taxable increase on goods they had already shipped, and therefore, could not have avoided criminal penalties under the retroactive statute.¹⁶⁸ In *NationsBank*, the taxpayer had already paid the additional tax required by the statute and, therefore, was not at risk of having criminal sanctions imposed on them by the government.¹⁶⁹ Because of this distinction, the court reasoned that the holding by the Supreme

159. *Id.* at 1336.

160. *Id.* at 1335.

161. *Id.*

162. *Id.* at 1336.

163. *Id.*

164. *Id.*

165. *Id.*

166. *Id.*

167. *Burgess*, 97 U.S. at 384.

168. *NationsBank*, 269 F.3d at 1336.

169. *Id.*

Court in *Burgess* did not apply to the case in *NationsBank*.

Takings Clause Argument

The court in *NationsBank* held that the retroactive estate tax statute contained in the *OBRA* was not a violation of the Takings Clause. The court began its analysis by citing *Nichols v. Coolidge*, which stated that a retroactive tax may constitute a taking under the Fifth Amendment if the retroactive feature makes it “so arbitrary and capricious as to amount to confiscation.”¹⁷⁰ However, the court stated that because the taxpayer’s retroactivity argument failed under the due process standards discussed below, it also failed “arbitrary and capricious” standard of the Takings Clause.¹⁷¹

Citing *United States v. Darusmont*, the court also stated that a retroactive tax could be considered a taking if the retroactive reach extends beyond “short and limited periods required by the practicalities of producing national legislation.”¹⁷² In determining whether the retroactive reach fell within the “short and limited period” standard, the court used the date from when the legislative process began, rather than the date §13208 was enacted.¹⁷³ Because the legislative process began in February of 1993, and the retroactive reach was extended back to January 1, 1993, the court held that this was a “modest” revision under the *Carlton* standard and, therefore, encompassed only a “short and limited” period as required by *Darusmont*.¹⁷⁴

Due Process Clause Argument

Based on the standard set forth by the Supreme Court in *Carlton*, the court held that §13208 was not a violation of due process.¹⁷⁵ Citing *Carlton*, the court stated that in order for retroactive legislation to satisfy the Due Process Clause, “a rational legislative purpose” must justify its enactment.¹⁷⁶ Citing *Usery v. Turner Elkhorn Mining Co.*, the court further stated that “the burden is on one complaining of a due process violation to establish that the legislature has acted in an arbitrary and irrational way.”¹⁷⁷

Noting that the Court in *Carlton* found a fourteenth-month retroactive period to be “modest” and valid, the court stated *NationsBank* had not shown that the eight-month retroactive period was arbitrary and irrational.¹⁷⁸ The court also held that the uniform fifty-five percent rate on all estate tax transfers was sufficient to show that

170. *Id.* (citing *Nichols*, 274 U.S. at 542-43).

171. *Id.* at 1337.

172. *Id.* (citing *United States v. Darusmont*, 449 U.S. 292, 296-97 (1981)).

173. *Id.* at 1336-37.

174. *Id.* at 1337.

175. *Id.*

176. *Id.* (citing *Carlton*, 512 U.S. at 31).

177. *Id.* (citing *Usery*, 428 U.S. at 15).

178. *Id.*

the legislature had a rational purpose for the retroactive enactment.¹⁷⁹ Therefore, NationsBank failed to show that §13208 was a violation of the Due Process Clause.

Equal Protection Clause Argument

Finally, the Court in *NationsBank* held that §13208 of the *OBRA* did not violate the Equal Protection Clause of the Fourteenth Amendment.¹⁸⁰ NationsBank argued that §13208 violated the estate's equal protection rights under the laws by requiring it to pay taxes at a rate higher than was required when the taxable event occurred (the death of the decedent).¹⁸¹ However, rather than discriminating against a narrow group of taxpayers, the court held that §13208 actually promoted tax equity by requiring the heirs of decedents who died from January to August of 1993 to pay the same rate in estate taxes as those heirs who decedents died following August 1993.¹⁸² The court stated that if it were not for the retroactive effect of §13208, the heirs to the decedents who died prior to August of 1993 would be given advantageous treatment and, therefore, it actually furthered equal protection principles rather than violated them.¹⁸³

PART VI: POTENTIAL RAMIFICATIONS OF IMPOSING A RETROACTIVE ESTATE TAX IN 2010

If Congress were to have retroactively imposed an estate tax in 2010, it would have had both positive and negative ramifications. Part VI.A will first examine the arguments in favor of retroactive tax legislation and then Part VI.B will discuss the arguments against imposing a retroactive estate tax on heirs.

A. Benefits of Retroactive Taxation

Proponents of retroactive tax legislation have noted several benefits that applying taxes retroactively would have on the United States. To begin with, they argue that retroactive tax legislation can be necessary to prevent revenue loss.¹⁸⁴ Advocates of retroactive tax legislation argue that it would be improper to allow a tax loophole to continue for even a short period of time while the United States Treasury is suffering.¹⁸⁵ As discussed above, in this case, the fact that Congress did not retroactively apply estate taxes to decedents who died in 2010 could have cost the United States government up to an estimated \$14.8 billion dollars.¹⁸⁶

179. *Id.*

180. *Id.* at 1338.

181. *Id.*

182. *Id.*

183. *Id.*

184. Note, *Setting Effective Dates for Tax Legislation: A Rule of Prospectivity*, 84 HARV. L. REV. 436, 441 (1970).

185. *Id.*

186. Whoriskey, *supra* note 7.

Proponents of retroactive tax legislation argue that, especially while the United States government is in a recession, that is revenue that cannot afford to be lost.¹⁸⁷

Proponents of retroactive taxation also argue that fairness demands that corrections to tax loopholes be made retroactively in order to put all taxpayers on equal footing.¹⁸⁸ The case of George Steinbrenner is a perfect illustration of this argument. Because Mr. Steinbrenner died prior to January 1, 2011, his heirs could elect not to have the *2010 Tax Relief Act* applied to his estate, therefore avoiding the estate tax. However, if someone in a similar situation had died on January 1, 2011, their estate could not have made that election and would be forced to pay hundreds of millions of dollars in estate taxes. Proponents of retroactive legislation argue that it is not fair to apply the new tax legislation to the second decedent, and not to George Steinbrenner, who just happened to die in the right tax window.

B. Negative Ramifications of Retroactive Taxation

Critics of retroactive taxation have argued that, from a practical standpoint, it creates a lack of fairness and predictability that far outweighs the benefits it provides. Critics argue that “[r]etroactivity often defeats reliance and penalizes a taxpayer for acting in a manner which was previously permitted. This is both harsh and inequitable.”¹⁸⁹ As illustrated in *Carlton*, many times taxpayers engage in transactions as a part of a tax planning strategy. If the taxpayers cannot have faith that the provisions they are relying on will not be retroactively changed by Congress, they cannot make financial decisions with any level of confidence and, as stated by a critic of retroactive tax legislation, “it is impossible to quantify the cost resulting from the loss of taxpayer confidence in the taxing system due to the perceived inequities produced by retroactivity.”¹⁹⁰

In his analysis of retroactive legislation, Charles Hochman elaborated on these arguments as to why Congress should refrain from enacting laws retroactively.¹⁹¹ He began by referencing James Madison’s desire to protect people from “fluctuating policy” of the legislature.¹⁹² He stated that “to the extent that statutory law should serve as a guide to individual conduct, this purpose is thwarted by retroactive amendments.”¹⁹³ He further argued that retroactive legislation promotes hostility from taxpayers because statutes may be passed by Congress with an exact understanding of whom they will benefit and who they will hurt.¹⁹⁴

Therefore, critics argue that retroactive tax legislation diminishes the predictability in the law and fails to protect taxpayers from changes that they cannot control. Especially in the tax field where knowledge of the law is vital to successful

187. *Id.*

188. *Setting Effective Dates for Tax Legislation: A Rule of Prospectivity*, *supra* note 184, at 441.

189. *Id.* at 439.

190. *Id.* at 441.

191. Hochman, *supra* note 29, at 693.

192. *Id.*

193. *Id.*

194. *Id.*

long-range planning, retroactive taxation diminishes the confidence that taxpayers can have in their investment strategy.

PART VII: CONCLUSION - SHOULD CONGRESS IMPOSE THE ESTATE TAX RETROACTIVELY?

Part VII will discuss whether or not Congress could impose the estate tax from the *2010 Tax Relief Act* retroactively, and if so, if it would be beneficial for them to do so. Part VII.A will analyze whether it would be constitutional for Congress to impose the estate tax retroactively, based on the case law from *Carlton* and *NationsBank*. It will also discuss what limitations, if any, Congress must abide by in retroactively applying the law. Part VII.B will discuss whether the benefits of imposing the estate tax retroactively outweigh the negative ramifications that it could have on the taxpayers. The note will end by discussing whether or not Congress made the correct decision in refraining from applying the estate tax retroactively to families such as the Steinbrenners.

A. *Constitutionality of Retroactive Estate Tax*

Based on the Supreme Court’s analysis of retroactive taxation in *Carlton* and the recent Court of Appeals decision in *NationsBank*, if Congress had hypothetically decided to apply the estate tax from the *2010 Tax Relief Act* retroactively, it would probably be held to be constitutional.

As was the case in *NationsBank*, the taxpayer could first attempt to argue that the retroactive tax legislation was unconstitutional based on the Apportionment Clause, the Ex Post Facto Clause, the Takings Clause, and the Equal Protection Clause. However, these arguments will all probably fail based on the court’s decision in *NationsBank*.

As was the case with §13208 of the *OBRA* in *NationsBank*, the retroactive estate tax amendment would be considered a tax on the transfer of property (from the decedent to the heir), rather than on the property itself, making it constitutional under the Apportionment Clause. Similarly, as was the case in *NationsBank*, the Court would also strike down an ex post facto argument using the reasoning of *Calder* which limited the Ex Post Facto Clause as applying solely to criminal enactments. The argument that the retroactive enactment violates the Takings Clause would probably not succeed because, as stated by the Court in *Nichols*, it is not “so arbitrary and capricious as to amount to confiscation.”¹⁹⁵ Finally, the argument that the retroactive legislation violates the Equal Protection Clause would also be unsuccessful because, as the court stated in *NationsBank*, the retroactive estate tax legislation would actually promote tax equity by requiring heirs of decedents who died in the year 2010 to pay the same estate tax rate as those heirs whose decedents died after that date.

Similar to the case in *Carlton*, the taxpayer’s primary argument against the

195. *Nichols*, 274 U.S. at 542.

retroactive estate tax would be that it is a violation of the Due Process Clause. However, following the precedent set by the Supreme Court in *Carlton*, the taxpayer would probably not be successful in this argument. The standard used by the Court in *Carlton* for determining whether retroactive legislation met the requirements of due process is whether it is “rationally related to a legitimate legislative purpose.”¹⁹⁶ In determining that the amendment to the tax code was constitutional in *Carlton*, the Court noted that it was “neither illegitimate nor arbitrary” and that Congress “established only a modest period of retroactivity.”¹⁹⁷ In this case, because the government is losing billions of dollars in revenue as a result of the lack of an estate tax for 2010, it would probably be considered a “legitimate legislative purpose.”¹⁹⁸

The taxpayer could attempt to make the same argument used against the retroactive application in *Carlton*, that it was unduly “harsh and oppressive,” however that would probably not be successful. The Steinbrenners’ argument that a retroactive estate tax is “harsh and oppressive” is actually weaker than the taxpayer’s losing argument in *Carlton*. In *Carlton*, the taxpayer acted in reliance on the statute that was retroactively changed by purchasing the MCI stock to gain an estate tax advantage, whereas George Steinbrenner did not take any action based on the estate tax legislation, he just happened to die in the window when there was no estate tax. Also, as the Supreme Court acknowledged in *Carlton*, that authority “has [been] long since discarded” and is now limited to cases involving “the creation of a wholly new tax.”¹⁹⁹ Therefore, because Congress is just changing the rate of the estate tax which has existed for years, rather than creating an entirely new tax, this argument would probably fail.

Although Congress would probably have the power to enact the legislation retroactively, it might be limited on the amount of time it can take to enact the retroactive legislation based on Justice O’Connor’s concurrence in *Carlton*. In her concurring opinion, Justice O’Connor noted that in the prior cases in which retroactive legislation survived a due process challenge the law applied retroactively “for only a relatively short period prior to enactment.”²⁰⁰ She went on to say that a retroactive period of longer than a year would, in her opinion, raise serious constitutional questions.²⁰¹ Therefore, although it is unknown whether the rest of the current Court shares Justice O’Connor’s opinion, Congress’ ability to enact a retroactive law might be limited to a time period as short as one year in length.

However, because Congress enacted the estate tax legislation on December 17, 2010, if it had hypothetically decided to apply it retroactively, it would have created a retroactive period of less than a year. Therefore, if Congress had chosen to enact retroactive estate tax legislation in 2010, rather than allowing estates to elect out of

196. *Carlton*, 512 U.S. at 35.

197. *Id.* at 31-32.

198. *Id.* at 35.

199. *Carlton*, 512 U.S. at 31-32.

200. *Id.* at 38.

201. *Id.*

retroactive application, it would probably have survived a constitutional challenge based on due process.

B. *Should Congress Enact Retroactive Estate Tax Legislation?*

Based on its precedent in *Carlton*, the Supreme Court probably would have held the hypothetical retroactive application of the estate tax in 2010 to be constitutional. Therefore, the question becomes: Should Congress have applied the 2010 estate tax retroactively? In making the determination of whether or not to enact retroactive tax legislation, Congress must balance its interest in creating revenue and promoting fairness with its interest in protecting the taxpayer from "fluctuating policy."²⁰²

In this case, based on the totality of the circumstances, Congress should have applied the *2010 Tax Relief Act* retroactively, rather than giving the estates an opportunity to elect out of the retroactive application. The argument given by critics of retroactive tax legislation, that it "penalizes a taxpayer for acting in a manner which was previously permitted,"²⁰³ is inapplicable in this case, as no taxpayer performed any action in reliance on the estate tax legislation. Unlike the taxpayer in *Carlton*, who purchased stock in reliance on a statute that was retroactively amended, it was not part of George Steinbrenner's estate planning strategy to die in the year 2010. While the lack estate tax was a convenient benefit he received based on the timing of his death, he did nothing to receive the benefit other than dying. The only taxpayers who could have taken any action in reliance on the estate tax legislation would be those who deliberately took their own lives in 2010 to reduce the tax burden on their estates, and for policy reasons that is not a reliance the government should be worried about protecting. It is also important to note that, although Congress did not enact the estate tax legislation until December of 2010, this legislation had been anticipated for years which gave estate planners the necessary time to make alternative plans in the event that it did occur.

Although it is important for taxpayers to have confidence that the provisions they rely on will not be retroactively changed, because there was no legal action that a taxpayer could have taken in reliance on the 2010 estate tax legislation, Congress should have placed more of an emphasis on promoting equity between taxpayers. From a policy standpoint, it is not equitable that the estate of a decedent who died on December 31, 2010, can elect to avoid paying an estate tax, while the estate of a person who died the next day on January 1, 2011, could be required to pay hundreds of millions of dollars in taxes. Instead, it is only fair that Congress enact retroactive estate tax legislation that will result in estates of similar values paying similar amounts of taxes. In this case, because there could be a drastic disparity between the amount of taxes paid on similar estates, Congress should have prioritized finding a way to ensure parity by requiring the estates of all decedents who died in 2010 to pay an amount comparable to that which will be paid by estates

202. Madison, *supra* note 30.

203. *Setting Effective Dates for Tax Legislation: A Rule of Prospectivity*, *supra* note 184, at 439.

of those who die in 2011.

However, because Congress allowed the estates of decedents to elect out of the 2010 estate tax, it potentially sacrificed \$14.8 billion in tax revenue and created major inequity in the tax system.²⁰⁴ While the estates of decedents who died on or after January 1, 2011, are required to pay estate taxes, for the Steinbrenner family and the estates of other decedents who died in 2010, Congress' decision not to retroactively apply the *2010 Tax Relief Act* means death without taxes.

204. Whoriskey, *supra* note 7.